Bachus: Lehman Brothers Report Raises Serious Concerns About The Capability Of The Federal Reserve To Conduct Bank Supervision

WASHINGTON -Financial Services Committee Ranking Member Spencer Bachus made the following statement during a Full Committee hearing entitled "Examining the Link Between Fed Bank Supervision and Monetary Policy."

"As Congress looks at ways to reform the country's financial infrastructure, we need to ask whether bank supervision is central to central banking. It is worth examining whether the Federal Reserve should conduct monetary policy at the same time it regulates and supervises banks, or whether it should concentrate exclusively on its macroeconomic responsibilities. It's no exaggeration to say that the health of our financial system depends on getting this answer right.

"Frankly, the Fed's performance as the holding company supervisor has been inadequate. In spite of its oversight, many of the large, complex banking organizations excessively leveraged and engaged in off-balance sheet transactions that helped precipitate the financial crisis. Just this past week, the report of Lehman Brothers' court-appointed bankruptcy examiner was made public. The report details how Lehman Brothers used accounting gimmicks to hide its debt and mask its insolvency.

"According to the New York Times, all this happened while a team of officials from the Securities and Exchange Commission and the Federal Reserve Bank of New York were resident examiners in the headquarters of Lehman Brothers. As many as a dozen government officials were provided desks, phones, computers - and access to all of Lehman's books and records. Despite this intensive on-site presence, the New York Fed and the SEC stood idly by while the bank engaged in the balance sheet manipulations detailed in the report. This raises serious questions regarding the capability of the Fed to conduct bank supervision.

"Yet even if supervision of its regulated institutions improves, it is not clear that oversight really informs monetary policy. If supervision does not make monetary policy decisions better, then the two do not need to be coupled. Vince Reinhart, a former director of the Fed's Division of Monetary Affairs and now a resident scholar at the American Enterprise Institute, said that collecting diverse responsibilities in one institution is like ‘asking a plumber to check the wiring in your basement.'

"It seems that when the Fed is responsible for monetary policy and bank supervision, its performance in both suffers. Macroeconomic issues cloud supervisory judgments, thereby imperiling safety and soundness. There are inherent conflicts of interest, where the Fed may be tempted to conduct monetary policy in such a way that hides its mistakes by protecting the struggling banks it supervises.

"An additional problem arises when the supervision of large banks is separated from smaller institutions. Under the Dodd proposal, the Fed would supervise 40 or 50 large banks, and the other 7,500 or so banks would be under the regulatory purview of other Federal and state banking agencies. The Fed's focus on the mega-banks will inevitably disadvantage the regional and community banks.

"H.R. 3310, the House Republican regulatory reform plan, would correct these problems. It would re-focus the Fed on its monetary policy mandate by relieving it of regulatory and supervisory responsibilities and reassigning them to a consolidated regulator. By contrast, the regulatory reform legislation that passed the House in December (H.R. 4173) represented the largest expansion of the Fed's regulatory role since its creation almost one hundred years ago. Senator Dodd has strengthened the Fed even more. His regulatory reform bill empowers the Fed to regulate systemically significant financial institutions and to enforce strict standards for institutions as they grow larger and more complex; adopts the Volcker Rule to restrict proprietary trading and investments by banks; and creates a new consumer financial protection bureau to be housed at and funded by the Fed.

"In my view, the Democrats are asking the Fed to do too much.

"Thank you again, Mr. Chairman, for holding this hearing, and I look forward to the testimony."